

Message Text

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PAGE 01 LIMA 00525 01 OF 02 191835Z

44

ACTION ARA-10

INFO OCT-01 ISO-00 AGR-05 CEA-01 CIAE-00 COME-00 DODE-00

EB-07 FRB-03 H-02 INR-07 INT-05 L-03 LAB-04 NSAE-00

NSC-05 PA-01 AID-05 CIEP-01 SS-15 STR-04 TAR-01

TRSE-00 USIA-06 PRS-01 SP-02 FEAE-00 OMB-01 /090 W

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TP RUEHC/SECSTATE WASHDC 8431

INFO AMEMBASSY QUITO

AMEMBASSY SANTIAGO

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SUBJ: PERSPECTIVES FOR THE PERUVIAN ECONOMY IN 1976

REF: LIMA 0457

1. SUMMARY: THE PERSPECTIVES FOR THE PERUVIAN ECONOMY IN 1976 ARE SOMBER. THIS CABLE ANALYZES THE OBJECTIVES MADE PUBLIC BY THE MINISTER OF ECONOMY AND FINANCE IN HIS SPEECH OF JANUARY 12, THE POINTS OF ECONOMIC DISTRESS WHICH THE GOP'S AUSTERITY PROGRAM AIMS TO OVERCOME, SPECIFIC PROBLEMS WHICH MAY BE AGGRAVATED BY THE MEASURES ENACTED, AND THE LIKELY POLITICAL AND ECONOMIC RESULTS.

END SUMMARY.

2. THERE CAN BE LITTLE DOUBT THAT THE PROGRAM PRESENTED BY MINISTER BARUA ON JANUARY 12 IS THE PRODUCT OF MEASURED CONSIDERATION OF THE PROBLEMS AFFLICTING THE PERUVIAN ECONOMY. HE PRESENTED PROJECTIONS FOR PERU'S BALANCE OF PAYMENTS, ECONOMIC GROWTH AND INFLATION, AS WELL AS FISCAL OPERATIONS. THE ONLY SUBJECT NOT PRESENTED WAS THE MONETARY PROGRAM

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PAGE 02 LIMA 00525 01 OF 02 191835Z

(WHICH THE GOP IS WORKING ON AT THE PRESENT TIME). WE BELIEVE,

HIS PROJECTIONS ARE RATHER OPTIMISTIC, GIVEN THE ECONOMIC CONDITIONS OF PERU TODAY. HOWEVER, THEY ARE WITHIN THE PERMISSIBLE LIMITS OF A FINANCE MINISTER IN A PUBLIC PRESENTATION.

3. THE MINISTER'S SPECIFIC PROJECTIONS FOR PERU'S BALANCE OF PAYMENTS AND GROSS DOMESTIC PRODUCTS FOLLOW:

BALANCE OF PAYMENTS	1975	1976
EXPORTS FOB	1,378	1,655
IMPORTS FOB	2,491	2,520
TRADE BALANCE	-1,113	-865
CURRENT ACCOUNT BALANCE	-1,568	-1,391
LONG TERM CAPITAL	1,137	1,085
NET BASIC BALANCE	1 431	- 306
SHORT TERM CAPITAL(AND ERRORS AND OMMISIONS)	- 112	306
BALANCE OF PAYMENTS	- 543	0

GROSS DOMESTIC PRODUCT	1975	1976
GROSS DOMESTIC PRODUCT	4.0	5.5
AGRICULTURE	1.0	3.2
FISHING	-18.1	46.8
MINING	-10.4	12.0
INDUSTRY	6.0	6.0
CONSTRUCTION	15.0	9.0
OTHER	5.1	4.0
LIMA CONSUMER PRICE INDEX		
(PERCENTAGE INCREASE)	24.0	20.0

4. IN HIS SPEECH MINISTER BARUA NOTED THE POINTS OF ECONOMIC DISTRESS THE GOP'S 1976 PROGRAM AIMS TO CORRECT. THEY ARE INFLATION, PUBLIC SECTOR SAVING, RECESSION, DETERIORATION IN THE DISTRIBUTION OF INCOME, AND INADEQUATE DOMESTIC PRODUCTION. IN REGARD TO INFLATION THE PROGRAM IS AN ATTEMPT TO SET LIMITS TO WAGE INCREASES THAT WOULD BE COMPATIBLE WITH A RATE OF INFLATION WHICH IS LOWER THAN THAT OF 1975. IN REGARD TO PUBLIC SECTOR SAVING, THE PROGRAM AIMS TO IMPROVE CENTRAL GOVERNMENT FINANCES, AND OTHER THINGS BEING EQUAL THIS IMPROVEMENT SHOULD REDUCE THE RATE OF EXPANSION OF NET DOMESTIC CREDIT AND DOMESTIC LIQUIDITY. IN REGARD TO RECESSION, THE MINISTER EMPAHSIZED THAT THE GOP WOULD CONTINUE THE PUBLIC SECTOR LIMITED OFFICIAL USE

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PAGE 03 LIMA 00525 01 OF 02 191835Z

INVESTMENT PROGRAM AT PRESENT LEVELS BECAUSE IT GENERATES INCOME, EMPLOYMENT, AND FUTURE FOREIGN EXCHANGE EARNINGS. HOWEVER, THE IMPACT OF REDUCED GOVERNMENT SPENDING AND INCREASED TAXES IN THEMSELVES AIM TO REDUCE AGGREGATE DEMAND, AND IT SHOULD BE NOTED THAT INFLATION TENDS TO REDUCE THE REAL INCOMES IN MANY SEGMENTS OF THE ECONOMY. THE MINISTER NOTED THE WORLDWIDE PHENOMENA OF INFLATION WITH RECESSION AND STATED THAT THIS HAD NOT YET OCCURRED IN PERU.

(EMBASSY COMMENT: THE SLIGHT ECONOMIC GROWTH OF 1975 SUGGESTS THAT THIS MAY ALSO OBTAIN IN PERU.) THE WAGE INCREASE GUIDELINES WILL UNDOUBTEDLY REDUCE THE EROSION OF REAL INCOMES. FURTHER, GUIDELINES ARE BETTER THAN NONE AT ALL, PARTICULARLY FOR UNORGANIZED LABOR WHICH HAS LITTLE OR NO BARGAINING LEVERAGE. IN REGARD TO PRODUCTION, INCREASED PRICES OF BASIC FOODSTUFFS MAY STIMULATE (OR PREVENT FURTHER DETERIORATION IN) AGRICULTURAL PRODUCTION AND HELP MAINTAIN REAL INCOMES IN THE AGRICULTURAL SECTOR.

5. IN EVALUATING THE GOP PROGRAM, THE ELEMENTS WHICH APPEAR CLEAR ARE (1) AN ATTEMPT TO IMPROVE THE FISCAL SITUATION, (2) AN ATTEMPT TO SET PRICE AND WAGE GUIDELINES COMPATIBLE WITH REDUCING INFLATION, AND (3) A PARTIAL ACCEPTANCE OF THE USE OF THE PRICE SYSTEM IN THE ALLOCATION OF ECONOMIC RESOURCES. THE LEGAL MEASURES RELATED TO TAXES, PRICES, AND WAGES ARE GENERALLY CLEAR IN EFFECT AND DEGREE. MANY OF THE PRICE INCREASES WE RE NECESSARY TO ADJUST DOMESTIC PRICES TO THE EFFECTS OF THE SEPTEMBER 1975 DEVALUATION, AND IN SPECIFIC CASES, SUCH AS PETROLEUM PRODUCTS, THE FISCAL BURDEN WAS QUITE ONEROUS. FROM A FISCAL POINT OF VIEW REDUCED SUBSIDIES YIELD REVENUES WHICH ARE EQUIVALENT TO INCREASES IN INDIRECT TAXES. FOR THIS REASON, THE POLITICAL TRADE-OFF INVOLVED INCREASED TAXES ON THE UPPER INCOME INDIVIDUAL AND THE PRIVATE BUSINESS SECTOR. THE TAX MEASURES RELATED TO BALANCE OF PAYMENTS ARE LIKELY TO ACCOMPLISH LITTLE IN TERMS PERU'S PRESENT B/P EMERGENCY.
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PAGE 01 LIMA 00525 02 OF 02 191842Z

44

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LIMITED OFFICIAL USE SECTION 2 OF 2 LIMA 0525

6. THERE ARE DISADVANTAGES AS WELL AS ADVANTAGES TO AN ANNOUNCEMENT OF A SET OF MEASURES WHICH COMPRISE THE AUSTERITY PROGRAM. THE PRINCIPAL DISADVANTAGE IS THAT IF THE GOP IS FORCED TO RETREAT FROM WAGE GUIDELINES BY ORGANIZED LABOR OR FROM THE PRICE GUIDELINES BY BALANCE OF PAYMENTS DIFFICULTIES THAT MAY EMERGE DURING 1976, SUCH A RETREAT MIGHT DIMINISH THE PRESTIGE AND AUTHORITY OF THE MORALES BERMUDEZ GOVERNMENT. THE ADVANTAGE OF PROGRAM AS ANNOUNCED IS THAT GUIDELINES ON WAGES AND PRICES, AS WELL AS THE GENERAL EMPHASIS ON AUSTERITY, MAY STRENGTHEN THE HAND OF THE ECONOMY'S FINANCIAL MANAGERS AS THEY GRAPPLE WITH DECISION MAKERS OF PUBLIC SECTOR ENTITIES AND AT THE CABINET LEVEL.

7. THE PRINCIPAL PROBLEMS OF POLITICAL ECONOMY FOR THE GOP IN 1976 WILL BE LABOR UNREST AND EXTERNAL ASSISTANCE. PROSPECTS FOR LABOR UNREST ARE EXAMINED IN PARA 8. ONE OF THE PURPOSES OF THE ANNOUNCED AUSTERITY PROGRAM IS UNDOUBTEDLY TO ENTICE THE INTERNATIONAL FINANCIAL COMMUNITY, BOTH PRIVATE BANKERS AND OFFICIAL INSTITUTIONS, TO ROLL-OVER LOANS AND TO EXTEND NEW CREDITS. THE GOP'S AUSTERITY PROGRAM SHOULD HAVE SOMEWHAT SALUTARY IMPACT ON THE PERCEPTION OF THE INTERNATIONAL FINANCIAL COMMUNITY.
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PAGE 02 LIMA 00525 02 OF 02 191842Z

NITY. THE SUBSTANTIAL LOSS OF EXTERNAL RESERVES IN 1975 TARNISHED PERU'S CREDITWORTHINESS. HOWEVER, THE AUSTERITY PROGRAM IS A FIRST STEP TOWARD BRAKING THE EXCESSIVE GROWTH OF DOMESTIC CREDIT AND LIQUIDITY THAT HAD CREATED THE RAPID GROWTH IN COMMODITY IMPORTS IN 1975. WE DO NOT HAVE ADEQUATE INFORMATION (SPECIFICALLY DETAILED GOP MONETARY AND B/P PROJECTIONS) TO PASS JUDGEMENT UPON THEIR INTERNAL CONSISTENCY NOR UPON THEIR CONSISTENCY WITH THE PROJECTED RATE OF INFLATION, THE INCREASED WAGE BILL, AND PROJECTED ECONOMIC GROWTH. THE IMF CONSULTATIVE GROUP COLLECTED DATA IN NOVEMBER (1975) AND THE IMF REPRESENTATIVE HERE IS ATTEMPTING TO UPDATE THE INFORMATION PREVIOUSLY COLLECTED.

8. ALTHOUGH WAGE INCREASES MAY IN THE SHORT RUN MITIGATE THE EFFECTS OF PRICE RISES FOR THE LOWEST PAID WORKERS, ORGANIZED LABOR IS UNLIKELY TO ACCEPT D.L. 21394 WITH EQUANIMITY. THE COLLECTIVE BARGAINING CEILING OF 55 SOLES PER DAY IS LESS THAN THE 70 SOLES PER DAY CEILING CONTAINED IN THE JUNE 30, 1975 ECONOMIC MEASURES. MINING AND METAL UNIONS STRUCK OFTEN IN LAST HALF 1975 IN EFFORT BREAK THROUGH 70 SOLES CEILING. WITH

AN ANTICIPATED INFLATION RATE FOR 1976 ONLY SLIGHTLY LOWER THAN THAT OF 1975, UNIONS CAN BE EXPECTED TO DO THEIR BEST TO BREAK THROUGH THE NEW 55 SOLES PER DAY MAXIMUM. THE DIRECT PROHIBITION ON COLLECTIVE BARGAINING OVER WORKING CONDITIONS, A CAUSAL FACTOR FOR MANY OF THE DISRUPTIVE 1975 STRIKES, IS ALSO EXPECTED TO BE REJECTED BY THE UNIONS. FAR LEFT UNIONS, STRONG IN THE MINING SECTOR, CAN BE EXPECTED TO CARRY OUT WORK STOPPAGES WHICH CONTRAVENE THE NEW ECONOMIC DECREES. THE COMMUNIST CGTP TRADE UNION, WHICH HAS POLITICALLY SUPPORTED THE GOVERNMENT BUT CARRIED OUT ITS FIRST GENERAL STRIKE (CONFINED TO LIMA/CALLAO AREA) AT END OF YEAR, CAN ALSO BE EXPECTED TO CHALLENGE THE DECREE. THE ECONOMIC PROGRAM IS LIKELY TO DECREASE POSSIBILITY OF LABOR PEACE AND, IN FACT, IT MAY INCREASE POSSIBILITY OF UNREST.

9. CERTAIN OTHER PROBLEMS MAY BE AGGRAVATED BY THE SPECIFIC DECREE LAW ALREADY ENACTED. THE SALARY LIMITATION SPECIFIED IN D.L. 21394 MAY ACCELERATE EMIGRATION OF PERSONS WITH SCARCE TECHNICAL AND MANAGERIAL SKILLS. THE FREEZING OF HOUSE RENTS MAY CAUSE PROBLEMS IN THE CONSTRUCTION INDUSTRY. THE IMPLEMENTATION OF A NON-DISRUPTIVE SYSTEM OF COMMODITY-LIMITED OFFICIAL USE

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PAGE 03 LIMA 00525 02 OF 02 191842Z

SPECIFIC PRIOR IMPORT LICENSES WILL BE DIFFICULT. SOME BUSINESSMEN SPECULATE THAT A TEMPORARY DISRUPTION OF IMPORTS MAY BE THE INTENDED PURPOSE.
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